



Office of City Auditor Memorandum

Date: July 17, 2003

To: Jan Tønning, Manager, Accounting and Finance, Department of Information Technology (DoIT)

From: Scottie Nix, Assistant City Auditor for Internal Controls

Subject: DoIT's Loss of Accounts Receivable Funds

Thank you for the opportunity to work with you and your staff during this project to improve DoIT's internal control system. Our work on this project resulted from a report of funds stolen from DoIT and your request for our assistance. Subsequently, we developed recommendations to help improve your department's controls over its accounts receivable process. It is my understanding that DoIT is implementing the recommendations that are contained in this memorandum.

Background:

In January 2002, a DoIT employee with accounts receivable duties resigned and notified the Seattle Police Department that he had stolen City funds. In February 2002, the Seattle Police Department notified Greg Klump, DoIT's former Finance Manager, that the former employee had confessed to stealing five payments totaling \$4,202. Mr. Klump determined that the former employee, before resigning, had had access to financial records and invoices for approximately two and a half months and had issued approximately \$175,000 of invoices.

Mr. Klump immediately notified the Office of City Auditor (OCA) and the State Auditors Office about the stolen funds. OCA agreed to work with DoIT to determine if there were additional funds missing and what steps DoIT should take to improve its accounts receivable process. In the late fall of 2002, you became the acting manager over this program and began working with OCA.

Results of our work:

DoIT and our office conducted an investigation, and verified the amount that the former employee reported to the Seattle Police that he had stolen. DoIT's May 2003 Summit system records in May 2003 for account receivable accounts showed a credit balance of \$1.8 million (i.e., the City owed this amount to DoIT's customers); however, the correct balance should have been a debit of about \$600,000 (i.e., DoIT's customers owe this to the City), which means there will need to be a \$2.4 million adjustment to DoIT's Summit records.

This memo contains several recommendations that should help DoIT improve its internal controls over accounts receivable funds.

Scope and methods:

This project focused on the accuracy and completeness of DoIT's records for external and internal customers who receive monthly invoices generated by the DoIT billing and accounts receivable system. We concentrated our efforts on records covering the period between September 2001 and March 2003.

We appreciate the time and effort your staff took to:

- Create a list of accounts receivable balances to document the checks and amounts stolen by the former employee.
- Determine DoIT's current account receivable balances listed in the Summit system and DoIT's internal accounts receivable system, and at the time we had completed our audit fieldwork, they had also almost completed the reconciliation of the two systems' balances.
- Use a positive account confirmation process to verify that DoIT was owed about \$600,000 from customer accounts.

Observations and recommendations:

1. Segregation of duties could be improved

Improving segregation of duties would help DoIT prevent future similar loss of funds. The individual who generated the invoices was also responsible for receiving payments and recording them in DoIT's accounts receivable system. These are incompatible duties. After the theft of funds was reported, the former DoIT Finance Manager separated these two incompatible duties to reduce the risk of a recurrence of the loss. However, these duties are no longer handled by different individuals, but by one person. You indicated that this situation would be corrected soon after DoIT hired a new Senior Accountant.

We recommend that the transition of account receivables accounting responsibilities to the new Senior Accountant be completed by June 30, 2003.

2. Scheduled billing policies and procedures could be improved

When we began working on this project, we noted that DoIT needed to bill its non-City department customers on a regularly scheduled basis. The current staff has addressed this issue, but DoIT still needs to develop formal, written policies and procedures governing the scheduled billing of accounts.

We recommend that DoIT develop formal, written accounts receivable policies and procedures for its external customers.

3. Prior DoIT management relied too much on customers to be the sole monitor of the account information

According to the former DoIT financial manager, customers were expected to notify him if their invoices were not reasonable. However, the invoices did not provide his name or phone number, which meant that customers would not know whom to contact when they had billing problems. Currently, the contact person listed on the invoices is also the person who issues the invoices to customers.

We recommend that all DoIT invoices be changed to include the name and phone number of a contact person who does not issue the invoices. We prefer that the invoice be changed to list the Manager of Accounting and Finance or his/her designee as the contact person for billing disputes.

4. Receipting and billing process could be improved

In the past, the person who issued DoIT's invoices was the person to whom the customer sent their remittances. It is likely that this is how the former employee who stole the funds was able to receive the checks, which he then deposited into his personal account.

We recommend that the cash receiving function in DoIT be transferred to the City Treasury office and that no remittances be sent directly to DoIT. However, if this is not possible, then DoIT's accounting section needs to designate a person as cashier who does not have the ability to make changes to the accounts receivable account records. DoIT also needs to ensure that two persons are assigned to work together to create a list of all checks and payments received each day. A third party should compare this list to the day's bank deposits. DoIT also needs to ensure that it complies with the City requirement to deposit all funds within 48 hours of receipt.

5. DOIT accounts receivable collection procedures needs improvement

DoIT needs a standardized process to follow up on customer accounts to help ensure that DoIT personnel pursue customer debts in a consistent, adequate manner. The City of Seattle has established procedures governing the collection of debts.¹

We recommend that DoIT actively begin to collect on all past due accounts receivable in accordance with the City's established procedures.

6. Accounts receivable account adjustment needed

As noted above, DoIT's accounts receivable balance required a \$2.4 million adjustment because it incorrectly indicated that DoIT owed its customers a credit balance of over \$1.8 million, when it actually should be a debit balance owed to DoIT of about \$600,000.

¹ The City procedures can be found on the inweb at <http://inweb/accountingservices/>. This site has the following procedures: Collection Outstanding Receivables, (Chapter 5, Section 10), Allowance Uncollectible Accounts, Receivable (Chapter 5, Section 20), and Accounts Receivable Write-Off (Chapter 5, Section 30).

A representative from the City's Central Accounting unit speculated that during the system conversion to Summit, some accounts receivable accounts were not set up, so the payments received from DoIT customers for those accounts did not have a corresponding account receivable to match against, which resulted in credit balances for many customers.

We recommend that the required Summit accounting adjustments be completed by August 1, 2003. Additionally, DoIT should develop a process to ensure that all unmatched Summit transactions are investigated immediately so that any necessary adjustments can be made to align the payments with the accounts receivable records.

cc: Jan Drago, Chair, City Council Finance, Budget, Business & Labor Committee
Jim Compton, Chair, City Council Police, Fire, Courts & Technology Committee
Sylvia Shiroyama, Acting Director, Department of Information Technology
Susan Cohen, City Auditor